



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

Audit report information can be accessed at:

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Michigan *Office of the Auditor General* **REPORT SUMMARY**

Financial Audit

Including the Provisions of the Single Audit Act

Report Number:
511-0100-08

Department of Military and Veterans Affairs

October 1, 2005 through September 30, 2007

Released:
July 2008

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Schedules:

Auditor's Report Issued

We issued an unqualified opinion on the Department of Military and Veterans Affairs' financial schedules.

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Internal Control Over Financial Reporting

We identified significant deficiencies in internal control over financial reporting (Findings 2 through 5). We do not consider these significant deficiencies to be material weaknesses.

~ ~ ~ ~ ~

Noncompliance and Other Matters Material to the Financial Schedules

We did not identify any instances of noncompliance or other matters applicable to the financial schedules that are required to be reported under *Government Auditing Standards*. However, we did identify other instances of noncompliance (Findings 1 and 5).

~ ~ ~ ~ ~

Federal Awards:

Auditor's Reports Issued on Compliance

We audited 2 programs as major programs and reported known questioned costs of \$24,186 and known and likely questioned costs totaling \$1,124,567. The Department expended a total of \$168.5 million in federal awards during the two-year period ended September 30, 2007. We issued 1 unqualified opinion and 1 qualified opinion. The opinions issued by major program are identified on the back of this summary.

~ ~ ~ ~ ~

Internal Control Over Major Programs

We identified significant deficiencies in internal control over federal program compliance (Finding 6). We consider Finding 6 to contain material weaknesses.

~ ~ ~ ~ ~

Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Finding 6).

~ ~ ~ ~ ~

Systems of Accounting and Internal Control:

We determined that the Department was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*.

~ ~ ~ ~ ~

We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
12.401	National Guard Military Operations and Maintenance (O&M) Projects	Unqualified
12.404	National Guard Civilian Youth Opportunities	Qualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

July 10, 2008

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
3411 North Martin Luther King Boulevard
Lansing, Michigan

Dear General Cutler:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Military and Veterans Affairs for the period October 1, 2005 through September 30, 2007.

This report contains our report summary, our independent auditor's report on the financial schedules, and the Department's financial schedules and schedule of expenditures of federal awards. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, this report contains the Department's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II and Section III of the schedule of findings and questioned costs. The agency preliminary responses are contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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INDEPENDENT AUDITOR'S REPORT AND FINANCIAL SCHEDULES



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Schedules

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
3411 North Martin Luther King Boulevard
Lansing, Michigan

Dear General Cutler:

We have audited the accompanying financial schedules of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

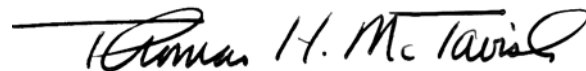
As described in Note 1, the financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for the Department of Military and Veterans Affairs' General Fund accounts, presented using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and other financing sources and the sources and disposition of authorizations of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2007 and September 30, 2006 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 27, 2008 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending from the left side of the first name.

Thomas H. McTavish, C.P.A.
Auditor General
June 27, 2008

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of General Fund Revenues and Other Financing Sources
Fiscal Years Ended September 30

	<u>2007</u>	<u>2006</u>
REVENUES		
Federal revenue:		
National Guard Bureau	\$ 30,849,417	\$ 30,523,802
Veterans Administration State Home Program	19,517,878	18,604,941
Medicare and Medicaid	2,858,208	2,105,131
U.S. Department of Education	96,713	
U.S. Department of Health and Human Services	42,757	75,373
Total federal revenues	<u>\$ 53,364,973</u>	<u>\$ 51,309,247</u>
Cost-of-care assessments	20,477,074	19,869,240
Armory Rental Program	95,193	99,444
Local agencies (Note 4)	1,253,100	
Miscellaneous	363,845	697,000
Total revenues	<u>\$ 75,554,185</u>	<u>\$ 71,974,931</u>
OTHER FINANCING SOURCES		
Proceeds from sale of capital assets - Armory sales	\$ 900,000	\$ 302,341
Less: Proceeds transferred to Department of Management and Budget capital outlay (Note 3)	(5,364)	
Total other financing sources	<u>\$ 894,636</u>	<u>\$ 302,341</u>
Total revenues and other financing sources	<u><u>\$ 76,448,821</u></u>	<u><u>\$ 72,277,272</u></u>

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30

	<u>2007</u>	<u>2006</u>
SOURCES OF AUTHORIZATIONS (Note 2)		
General purpose appropriations (Note 5)	\$ 39,299,200	\$ 39,689,100
Balances carried forward	1,918,870	5,004,064
Less: Transfer to Department of Management and Budget capital outlay (Note 3)	(283,638)	(2,189,782)
Restricted financing sources	76,892,902	72,524,662
Less: Intrafund expenditure reimbursements	<u>(651,148)</u>	<u>(557,549)</u>
Total	<u>\$ 117,176,185</u>	<u>\$ 114,470,495</u>
DISPOSITION OF AUTHORIZATIONS (Note 2)		
Gross expenditures and transfers out	\$ 113,232,656	\$ 112,869,089
Less: Intrafund expenditure reimbursements	(651,148)	(557,549)
Net expenditures and transfers out	<u>\$ 112,581,508</u>	<u>\$ 112,311,540</u>
Balances carried forward:		
Encumbrances	\$ 139,107	\$ 38,146
Restricted revenues - authorized	1,589,464	918,047
Restricted revenues - not authorized or used	1,439,076	962,677
Total balances carried forward	<u>\$ 3,167,647</u>	<u>\$ 1,918,870</u>
Balances lapsed	<u>\$ 1,427,030</u>	<u>\$ 240,085</u>
Total	<u>\$ 117,176,185</u>	<u>\$ 114,470,495</u>

The accompanying notes are an integral part of the financial schedules.

Notes to the Financial Schedules

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial schedules report the results of the financial transactions of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2007 and September 30, 2006. The financial transactions of the Department are accounted for principally in the State's General Fund and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. In addition, the Department is responsible for the supervision and direction of the Michigan Veterans' Trust Fund and the Military Family Relief Fund. These funds periodically receive separate financial and performance audits and are not included in the scope of this audit.

The notes accompanying these financial schedules relate directly to the Department of Military and Veterans Affairs. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; and pension benefits and other postemployment benefits.

b. Measurement Focus, Basis of Accounting, and Presentation

The financial schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by accounting principles generally accepted in the United States of America. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations

for the Department's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in conformity with accounting principles generally accepted in the United States of America.

Note 2 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

- a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenues.
- b. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - not authorized or used that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenues - not authorized or used. In addition to the amounts recorded in the financial schedules, the Department also had authorizations for large capital outlay projects that were accounted for by the Department of Management and Budget (DMB). The unexpended authorizations are carried forward by DMB and totaled \$51,767,745 for fiscal year 2006-07 and \$73,701,416 for fiscal year 2005-06.
- c. Restricted financing sources: Collections of restricted revenues and restricted transfers, net of restricted intrafund expenditure reimbursements, to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenues - authorized or restricted revenues - not authorized or used. The Department's restricted financing sources include federal revenue and cost-of-care assessments.

- d. Intrafund expenditure reimbursement: The Department used expenditure credits to offset the expenditures it incurred to provide services to the Michigan Department of State Police (MSP) for U.S. Department of Homeland Security grants. The U.S. Department of Homeland Security grants are the responsibility of MSP. These expenditures and associated revenue were reported in the financial schedules of MSP.
- e. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered during the fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.
- f. Restricted revenues - authorized: Revenues that, by statute or the Michigan Constitution, are restricted and authorized for use to a particular program or activity. Generally, these revenues may be expended upon receipt without additional legislative authorization. The Department had restricted revenues from the sale of land and armories owned by the Department.
- g. Restricted revenues - not authorized or used: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative appropriation. In fiscal year 2006-07, significant carry-forwards of this type included federal assistance of \$357,948 from the U.S. Department of Veterans Affairs and \$851,018 of cost-of-care assessments collected by the Grand Rapids Home for Veterans and the D.J. Jacobetti Home for Veterans. In fiscal year 2005-06, significant carry-forwards of this type included federal assistance of \$527,522 from the U.S. Department of Veterans Affairs and \$379,639 of cost-of-care assessments collected by the Grand Rapids Home for Veterans and the D.J. Jacobetti Home for Veterans.
- h. Balances lapsed: Authorizations that were unexpended and unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

Note 3 Department of Military and Veterans Affairs Armory Construction Fund

Act 150, P.A. 1967, created the Armory Construction Fund as a subfund of the General Fund. The proceeds from the sale of capital assets (land and armories) and interest earnings are deposited in the Fund and restricted for use in funding State armory capital outlay projects.

Armory capital outlay projects are primarily appropriated within DMB's Office of Design and Construction accounts. To provide spending authorization to cover construction costs, portions of the restricted carry-forward authorized balance are transferred to DMB as construction costs are incurred. In fiscal year 2006-07, a transfer of \$283,638 was recorded. In fiscal year 2005-06, a transfer of \$2,189,782 was recorded.

Note 4 ChalleNGe Program

The ChalleNGe Program is for high school dropouts aged 16 to 18 upon entry. The goal of the Program is to use the National Guard to improve education, life skills, and employment potential of participants by use of military-based training and supervised work experience. The Program is administered by the Department and funded in part with federal funds requiring a 40% match of State funds. Prior to fiscal year 2006-07, the State used General Fund/general purpose appropriations to fund the 40% State match requirement. In fiscal year 2006-07, State General Fund/general purpose appropriations were no longer used to provide the 40% State match requirement.

Instead, the Department entered into a contract with the Battle Creek Public School District. The purpose of this contract is to outline the terms and conditions upon which the district will utilize the program funding pursuant to the provisions of Section 24c, Act 342, P.A. 2006. The Battle Creek Public School District received a distribution from the School Aid Fund of \$1.3 million in accordance with Section 24c, Act 342, P.A. 2006. The contract directs the district to request, receive, and deposit these funds in the district's checking account and then, using a check drawn on the district's checking account, to forward these funds to the Department. The Department reports these funds as revenue from local agencies. The contract further requires the Department to utilize all funds received from the district to provide the State's 40% match requirement for the ChalleNGe Program.

Note 5 Military Retirement Benefits

The Department received annual appropriations for military retirement benefits for the Michigan National Guard members and special duty officers. These appropriations are made from the General Fund on a pay-as-you-go basis. Expenditures for the military retirement plan totaled \$3,141,035 for fiscal year 2006-07 and \$2,952,000 for fiscal year 2005-06. The actuarially determined unfunded liabilities for the military retirement plan as of September 30, 2007 totaled \$41.9 million.

SUPPLEMENTAL FINANCIAL SCHEDULE

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Schedule of Expenditures of Federal Awards (Note 1)
For the Period of October 1, 2005 through September 30, 2007

Federal Agency/Program	CFDA *	For the Fiscal Year Ended September 30, 2006			
		Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 2)	Total Expended, Distributed, and In-Kind Assistance
<u>U.S. Department of Defense</u>					
Direct Programs:					
National Guard Military Operations and Maintenance (O&M) Projects:					
Appendix 1 Army National Guard Real Property Operations and Maintenance (Note 3)	12.401	\$ 42,433,978	\$	\$ 2,673,586	\$ 45,107,564
Appendix 2 Army National Guard Environmental Resources Management	12.401	3,414,671		474,600	3,889,271
Appendix 3 Army National Guard Security Guard Activities	12.401	1,441,626			1,441,626
Appendix 4 Army National Guard Electronic Security System Operation & Maintenance	12.401	281,847			281,847
Appendix 5 Army National Guard Telecommunications	12.401	696,061			696,061
Appendix 6 Army National Guard Aviation Training Base Operations	12.401	52,420			52,420
Appendix 7 Army National Guard Sustainable Range Program	12.401	1,216,483		80,332	1,296,815
Appendix 10 Army National Guard Antiterrorism Program Manager Activities	12.401	62,208			62,208
Appendix 14 Office of the Chief - Administrative Services Activities	12.401	74,658			74,658
Appendix 21 Air National Guard Facilities Operations and Maintenance Activities	12.401	2,477,426		3,638,914	6,116,340
Appendix 22 Air National Guard Environmental Program Management	12.401	167,224			167,224
Appendix 23 Air National Guard Security Guard Services	12.401	1,440,246		49,008	1,489,254
Appendix 24 Air National Guard Fire Protection Activities	12.401	3,326,379		104,680	3,431,059
Appendix 40 Army National Guard Distance Learning Project	12.401	60,218			60,218
Total National Guard Military Operations and Maintenance (O&M) Projects		<u>\$ 57,145,445</u>	<u>\$ 0</u>	<u>\$ 7,021,120</u>	<u>\$ 64,166,565</u>
National Guard Civilian Youth Opportunities:					
ChalleNGe Program	12.404	\$ 1,717,159	\$	\$	\$ 1,717,159
Starbase Program	12.404		1,101,600		1,101,600
Total National Guard Civilian Youth Opportunities		<u>\$ 1,717,159</u>	<u>\$ 1,101,600</u>	<u>\$ 0</u>	<u>\$ 2,818,759</u>
Total U.S. Department of Defense		<u>\$ 58,862,604</u>	<u>\$ 1,101,600</u>	<u>\$ 7,021,120</u>	<u>\$ 66,985,324</u>
<u>U.S. Department of Veterans Affairs</u>					
Direct Programs:					
Grants to States for Construction of State Home Facilities	64.005	\$ 993,899	\$	\$	\$ 993,899
Veterans State Domiciliary Care	64.014	\$ 1,120,990			\$ 1,120,990
Veterans State Nursing Home Care	64.015	17,258,621			17,258,621
Total U.S. Department of Veterans Affairs (Note 4)		<u>\$ 19,373,510</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 19,373,510</u>
<u>U.S. Department of Education</u>					
Pass-Through Program:					
Michigan Department of Community Health (Note 5)					
Safe and Drug-Free Schools and Communities: State Grants	84.186	\$	\$	\$	\$ 0
Total U.S. Department of Education		<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
<u>U.S. Department of Health and Human Services</u>					
Pas-Through Program:					
Michigan Department of Community Health (Note 5)					
Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	\$ 75,373	\$	\$	\$ 75,373
Total U.S. Department of Health and Human Services		<u>\$ 75,373</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 75,373</u>
Total Expenditures of Federal Awards		\$ 78,311,487	\$ 1,101,600	\$ 7,021,120	\$ 86,434,207

* CFDA is defined as the *Catalog of Federal Domestic Assistance*.

See accompanying notes to the schedule of expenditures of federal awards.

For the Fiscal Year Ended September 30, 2007				Total Expended, Distributed, and In-Kind Assistance for the Two-Year Period
Directly Expended by Department	Distributed to Subrecipient	In-Kind Assistance (Note 2)	Total Expended, Distributed, and In-Kind Assistance	
\$ 35,879,374	\$	\$ 3,063,291	\$ 38,942,665	\$ 84,050,229
2,496,729		524,702	3,021,431	6,910,702
1,067,421			1,067,421	2,509,047
98,369			98,369	380,216
717,332			717,332	1,413,393
52,420			52,420	104,840
1,181,959		184,455	1,366,414	2,663,229
77,893			77,893	140,101
128,867			128,867	203,525
2,617,165		4,658,808	7,275,973	13,392,313
156,480			156,480	323,704
2,115,352		25,000	2,140,352	3,629,606
3,419,846		102,479	3,522,325	6,953,384
60,001			60,001	120,219
<u>\$ 50,069,208</u>	<u>\$ 0</u>	<u>\$ 8,558,735</u>	<u>\$ 58,627,943</u>	<u>\$ 122,794,508</u>
\$ 1,750,466	\$	\$	\$ 1,750,466	\$ 3,467,625
	1,770,061		1,770,061	2,871,661
<u>\$ 1,750,466</u>	<u>\$ 1,770,061</u>	<u>\$ 0</u>	<u>\$ 3,520,527</u>	<u>\$ 6,339,286</u>
<u>\$ 51,819,674</u>	<u>\$ 1,770,061</u>	<u>\$ 8,558,735</u>	<u>\$ 62,148,470</u>	<u>\$ 129,133,794</u>
\$ 241,303	\$	\$	\$ 241,303	\$ 1,235,202
\$ 1,136,347			\$ 1,136,347	\$ 2,257,337
18,410,823			18,410,823	35,669,444
<u>\$ 19,788,473</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 19,788,473</u>	<u>\$ 39,161,983</u>
\$ 96,713	\$	\$	\$ 96,713	\$ 96,713
<u>\$ 96,713</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 96,713</u>	<u>\$ 96,713</u>
\$ 42,757	\$	\$	\$ 42,757	\$ 118,130
<u>\$ 42,757</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 42,757</u>	<u>\$ 118,130</u>
<u>\$ 71,747,617</u>	<u>\$ 1,770,061</u>	<u>\$ 8,558,735</u>	<u>\$ 82,076,413</u>	<u>\$ 168,510,620</u>

Notes to the Schedule of Expenditures of Federal Awards

Note 1 Basis of Presentation

This schedule presents the federal grant activity of the Department of Military and Veterans Affairs on the modified accrual basis of accounting and in accordance with the requirements of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial schedules.

Note 2 In-Kind Assistance*

As part of the National Guard Bureau Cooperative Agreement, the U.S. Department of Defense provided in-kind assistance in the form of direct federal payment for services and supplies for the military operations and maintenance projects.

Note 3 Expenditures for Capital Outlay Projects

This schedule includes the cost of military operations and maintenance projects that are administered by the Office of Design and Construction, Department of Management and Budget (DMB). In accordance with State accounting policy, these costs are recorded as capital outlay expenditures by DMB. The Department requests and receives reimbursement from the National Guard Bureau, U.S. Department of Defense, and transfers the related revenue to DMB to cover the construction costs. However, because the Department is responsible for federal compliance related to these projects, the expenditures are also reported as directly expended on this schedule. Capital outlay federal expenditures related to military operations and maintenance projects totaled \$29,440,403 in fiscal year 2005-06 and \$22,740,320 in fiscal year 2006-07.

Note 4 Medicare and Medicaid Revenue

The Grand Rapids Home for Veterans and the D.J. Jacobetti Home for Veterans received federal Medicare revenue totaling \$1,808,604 in fiscal year 2005-06 and \$2,749,567 in fiscal year 2006-07. The Grand Rapids Home for

* See glossary at end of report for definition.

Veterans and the D.J. Jacobetti Home for Veterans received federal Medicaid revenue totaling \$296,528 in fiscal year 2005-06 and \$108,641 in fiscal year 2006-07. Medicare and Medicaid revenue is not considered federal assistance, but rather a purchase of services provided by the Homes. Therefore, the Medicare and Medicaid revenue is not included in this schedule.

Note 5 Pass-Through Identification Numbers

The pass-through entities did not provide the Department with pass-through identification numbers.

Note 6 Federal Revenue

The dollar amounts of expenditures reported on this schedule are not comparable to the federal revenue as shown on the schedule of General Fund revenues and other financing sources for the Department. These differences are attributable to several factors, including capital outlay expenditures recorded in DMB accounting records along with the corresponding federal revenue and other federal revenue transferred by the Department to other State departments to pay for service provided.

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
3411 North Martin Luther King Boulevard
Lansing, Michigan

Dear General Cutler:

We have audited the financial schedules of the Department of Military and Veterans Affairs for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents, and have issued our report thereon dated June 27, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in the next paragraph, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood

that a misstatement of the entity's financial schedules that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in Findings 2 through 5 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described in the third paragraph of this section is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted other instances of noncompliance as described in the accompanying schedule of findings and questioned costs as Findings 1 and 5.

The Department's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, others within the Department, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending from the left side of the first name.

Thomas H. McTavish, C.P.A.
Auditor General
June 27, 2008



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs
3411 North Martin Luther King Boulevard
Lansing, Michigan

Dear General Cutler:

Compliance

We have audited the compliance of the Department of Military and Veterans Affairs with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2007. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

As described in Finding 6 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding allowable costs/cost principles and reporting that are applicable to its National Guard Civilian Youth Opportunities Program. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the previous paragraph, the Department of Military and Veterans Affairs complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each of its major federal programs for the two-year period ended September 30, 2007.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the Department's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

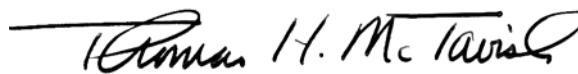
A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Finding 6 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We consider the significant deficiencies discussed in the preceding paragraph to be material weaknesses.

The Department's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, others within the Department, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General
June 27, 2008

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Schedules

Type of auditor's report issued: Unqualified*

Internal control* over financial reporting:

Material weaknesses* identified? No

Significant deficiencies* identified that are not considered to be material weaknesses? Yes

Noncompliance or other matters material to the financial schedules? No

Federal Awards

Internal control over major programs:

Material weaknesses* identified? Yes

Significant deficiencies* identified that are not considered to be material weaknesses? No

Type of auditor's report issued on compliance for major programs:

National Guard Military Operations and Maintenance (O&M) Projects Unqualified

National Guard Civilian Youth Opportunities Qualified*

Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?

Yes

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
12.401	National Guard Military Operations and Maintenance (O&M) Projects
12.404	National Guard Civilian Youth Opportunities

Dollar threshold used to distinguish between type A and type B programs: \$3,000,000

Auditee qualified as a low-risk auditee*? No

* See glossary at end of report for definition.

Section II: Findings Related to the Financial Schedules

FINDING (5110801)

1. Federal Reimbursements

The Department of Military and Veterans Affairs needs to improve its process for requesting federal reimbursement to help ensure timely collection of federal funds. Also, the Department should request all federal funds available to pay for program operations eligible for federal reimbursement. Improvement in the Department's federal reimbursement process would minimize the Department's negative cash position, increase an opportunity for the State to earn interest revenue, and reduce the State's costs associated with its operations of certain federal programs.

The Department's federal reimbursement requests are to be made in accordance with Section 18.1395(1) of the *Michigan Compiled Laws* and Department of Management and Budget (DMB) Administrative Guide procedure 1210.06. The *Michigan Compiled Laws* and DMB standards require the Department to minimize the time elapsing between the transfer of federal funds from the U.S. Department of Treasury and the disbursement of funds by the State. These standards also require the use of State General Fund/general purpose appropriations only after the available federal funds have been used. In addition, Executive Directive No. 2007-15, issued in March 2007, directed the Department to take all feasible actions to enhance the collection of amounts owed to the State for the remainder of the fiscal year.

During the majority of our audit period, the Department collected federal funds on a reimbursement basis to administer the operations of the National Guard Military Operations and Maintenance (O&M) Projects (CFDA 12.401) and the National Guard Civilian Youth Opportunities (CFDA 12.404). The Department initially paid for the operations of these programs using State funds and then billed the federal government for the federal share of the costs incurred. Our review of the Department's federal reimbursement process disclosed:

- a. The Department used a federal reimbursement process that, the Department informed us, generally took 76 days. We do not consider the Department's 76-day federal reimbursement process to be reasonable because it did not closely match the transfer of federal funds from the U.S. Department of Defense with the disbursement of State funds. Many other State departments

with large federal programs operate under federal reimbursement time frames of 1 to 7 days. The Department informed us that it was limited in its ability to collect timely reimbursements because the National Guard United States Property and Fiscal Office (USPFO) could only process reimbursement requests once every 30 days. However, the Department, in coordination with the USPFO, should study its process to identify ways to minimize the time elapsing between the use of State funds and the transfer of federal funds.

If the Department had collected federal reimbursement for the National Guard Military Operations and Maintenance (O&M) Projects (*CFDA* 12.401) and the National Guard Civilian Youth Opportunities (*CFDA* 12.404) operations within 30 days of the date the State warrant was paid, compared to the date the federal reimbursement was received, the Department could have reduced its average quarterly negative cash position of \$8,325,000 and provided the State with an opportunity to earn an estimated \$519,000 and \$345,000 in interest revenue in fiscal years 2005-06 and 2006-07, respectively. Negative cash position occurs during the time period when a State warrant is paid (State funds are used) and the Department has not collected federal reimbursement for federal program costs.

- b. The Department did not always adhere to its process and collect federal reimbursement within 76 days.

Our analysis identified that if the Department would have followed its 76-day process, it would have reduced its average quarterly negative cash position by \$1,834,000 and provided the State with the opportunity to earn an estimated \$252,000 and \$84,000 in interest revenue in fiscal years 2005-06 and 2006-07, respectively.

- c. The Department did not request federal reimbursement of available funds for operations related to the National Guard Civilian Youth Opportunities Program. The Department used general purpose appropriations instead of using available federal funds in the amounts of \$35,605 and \$12,746 for fiscal years 2005-06 and 2006-07, respectively.

RECOMMENDATIONS

We recommend that the Department improve its process for requesting federal reimbursement to help ensure timely collection of federal funds.

We also recommend that the Department request all federal funds available to pay for program operations eligible for federal reimbursement.

FINDING (5110802)

2. Schedule of Expenditures of Federal Awards (SEFA)

The Department's internal control over financial reporting did not ensure that it prepared its SEFA in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and State financial management policies. As a result, a risk exists for potential material misstatements in future SEFAs prepared by the Department.

OMB Circular A-133 requires the Department to prepare appropriate financial statements, including the SEFA, and to maintain internal control that provides reasonable assurance regarding the reliability of its financial reporting.

The Department lacked a formal process, including formal procedures, to help ensure a complete and accurate reporting of federal awards expended on its SEFA. As a result, our review of the Department's SEFA preparation process and its SEFA disclosed:

- a. The Department did not include the \$993,899 in federal awards expended from the Grants to States for Construction of State Home Facilities (CFDA 64.005) on its fiscal year 2005-06 SEFA.

The Department relied on certain accounting information to identify federal awards expended. However, the Department did not capture all necessary information to identify all federal programs. Formal procedures specifying how the Department should capture all necessary accounting information would help the Department ensure that it reports all federal awards expended on its SEFA.

OMB Circular A-133 requires that the SEFA provide total federal awards expended for each individual program and that the Department identify in its accounts all federal awards received and expended and the federal programs under which they were received.

- b. The Department did not include in-kind assistance of \$2,265,209 expended on behalf of the National Guard Military Operations and Maintenance (O&M) Projects (*CFDA* 12.401) for fiscal year 2005-06 on its SEFA.

Formal procedures that include the request of in-kind assistance, the employee position responsible for obtaining the information, and the date or time frame that the information should be requested would help the Department ensure that it gathers and reports the complete amount of in-kind assistance of federal awards on its SEFA.

OMB Circular A-133 requires the Department to disclose on its SEFA the value of the federal awards expended in the form of noncash assistance.

- c. The Department did not have a process of reconciling the SEFA to the Department's accounting records to ensure that the SEFA was accurate and complete. As a result, the Department did not detect misstatements on its SEFA. Our reconciliation of the Department's accounting records to the SEFA disclosed:

- (1) The Department understated the amounts reported as total expended, distributed, and in-kind assistance for the Veterans State Domiciliary Care (*CFDA* 64.014) by \$84,784 for fiscal year 2005-06.
- (2) The Department overstated the amounts reported as total expended, distributed, and in-kind assistance for the Veterans State Nursing Home Care (*CFDA* 64.015) by \$84,567 for fiscal year 2005-06.

The State of Michigan Financial Management Guide requires that the SEFA must be reconcilable to the information contained in the Department's financial schedules and accounting records.

- d. The Department did not report all federal programs by the correct federal agency, as either a direct program or a pass-through program, and did not include the pass-through entity* on its SEFA.

A formal policy to check federal and interagency grant agreements when preparing the SEFA could help ensure that the Department accurately designates its federal programs as direct or pass-through programs and that it identifies the pass-through entity.

For federal awards received as a subrecipient*, OMB Circular A-133 and the State of Michigan Financial Management Guide require the Department to disclose the name of the pass-through entity and identifying number assigned by the pass-through entity on its SEFA.

- e. The Department did not prepare the SEFA on the modified accrual basis of accounting in accordance with State financial management policies. The Department reported amounts for capital outlay expenditures of the National Guard Military Operations and Maintenance (O&M) Projects (*CFDA* 12.401) on the cash basis of accounting rather than the modified accrual basis. As a result, the Department overstated total expended, distributed, and in-kind assistance by \$2,924,313 in fiscal year 2005-06.

The Department reported capital outlay expenditures related to *CFDA* 12.401 based on the date it received reimbursement from the federal government, disregarding the actual date that expenditures incurred. This method does not take into account the current year's payables and inappropriately includes the prior year's payables.

The State of Michigan Financial Management Guide stipulates the amounts reported on the SEFA should be presented on the modified accrual basis of accounting.

After we brought these issues to the Department's attention, it appropriately revised its fiscal year 2005-06 SEFA that is presented in this report.

* See glossary at end of report for definition.

RECOMMENDATION

We recommend that the Department improve its internal control over financial reporting to ensure that the Department prepares its SEFA in accordance with OMB Circular A-133 and State financial management policies.

FINDING (5110803)

3. Internal Control Over Accounting Transaction Processing

The Department did not always separate the initiation and release of accounting transaction functions and did not have compensating controls for the lack of separation of duties. This increases the risk that improper or erroneous transactions could be processed without detection or correction in a timely manner.

We identified four individuals within the Department who both initiated and released over 1,300 accounting transactions related to 317 documents having a total dollar value of \$1.3 million dollars during our audit period. One of the four individuals we identified was responsible for processing most of these transactions. The Department informed us that it was necessary in some instances to have one individual initiate and release transactions because of limited personnel resources. Although we noted no impropriety in the 1,300 transactions, the Department did not have compensating controls, such as monitoring those transactions that were both initiated and released by the same individual or requiring a review of the transaction by an independent individual before the transaction was released. Without compensating controls, the Department lacks assurance regarding the propriety of those accounting transactions initiated and released by the same person.

The State of Michigan Financial Management Guide, Chapter 4, Section 400 requires the Department to implement compensating controls to mitigate the risk associated with a single user having the ability to process transactions.

RECOMMENDATION

We recommend that the Department separate the initiation and release of accounting transaction functions or develop and implement compensating controls for the lack of separation of duties.

FINDING (5110804)

4. Internal Control Over Food Purchases and Receipt

The Department did not have sufficient internal control over the purchase and receipt of food items at its Grand Rapids Home for Veterans (GRHV). As a result, the Department did not ensure that only authorized food purchases were ordered and that food purchases were received in the quantity ordered, received in good condition, and adequately safeguarded.

We reviewed 45 GRHV food service shipping invoices for the months of August 2006, October 2006, and August 2007. We determined that for 19 (42%) of the 45 invoices, GRHV did not document on the shipping invoice, or other Department specified forms, specific information regarding the receipt of the food items. For example, GRHV did not document who received the shipment, when the shipment was received, whether all items ordered were received, or if the items received were in good condition.

During the two-year period ended September 30, 2007, GRHV purchased \$3.1 million of food related items from its food vendor. Without sufficient policies and procedures regulating the purchase, receipt, and use of food items at GRHV, the Department lacks control over its food inventory. This situation could result in the State's limited resources being used inappropriately.

RECOMMENDATION

We recommend that the Department implement sufficient internal control over the purchase and receipt of food items.

FINDING (5110805)

5. Internal Control Over Records Retention

The Department did not have internal control to ensure that it maintained and safeguarded its hard copy accounting records. As a result, GRHV's hard copy accounting records related to fiscal years 2003-04 and 2004-05 were not maintained and safeguarded. Expenditures incurred by GRHV were approximately 40% of the Department's expenditures annually.

Maintaining and safeguarding hard copy accounting records is essential to ensure the integrity of the State's financial reporting by providing adequate supporting

documentation. Without such supporting documentation, subsequent reviewers of the State's financial transactions may lack the information necessary to determine the propriety of individual transactions.

Section 287, Act 431, P.A. 1984, established the records management program for the State. This program is responsible for the creation, retention, maintenance, preservation, and disposition of the records of the State. The records retention schedule established by the records management program requires the retention of hard copy accounting records for a minimum of five years.

GRHV management told us that it believed these hard copy accounting records were inadvertently sent to a document destruction firm in July 2007. Control procedures, including requiring management's written approval authorizing the movement of records, would help to ensure that accounting records are not lost or destroyed before the proper time. We could not validate that the accounting records were destroyed.

RECOMMENDATION

We recommend that the Department design and implement internal control to ensure that it maintains and safeguards its hard copy accounting records.

The status of findings related to the financial schedules that were reported in prior Single Audits* is disclosed in the summary schedule of prior audit findings.

* See glossary at end of report for definition.

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING (5110806)

6. National Guard Civilian Youth Opportunities, CFDA 12.404

U.S. Department of Defense	CFDA 12.404: National Guard Civilian Youth Opportunities
Award Number: FY05 Michigan ChalleNGe Youth Program FY06 Michigan ChalleNGe Youth Program	Award Period: 07/09/2005 - 07/08/2006 07/09/2006 - 07/08/2007
	Questioned Costs: \$24,186

The Department's internal control did not ensure that the National Guard Civilian Youth Opportunities Program complied with federal laws and regulations regarding allowable costs/cost principles and reporting. Our review disclosed material weaknesses in internal control and material noncompliance with compliance requirements related to allowable costs/cost principles and reporting. As a result, we identified known questioned costs totaling \$24,186 and known and likely questioned costs totaling \$1,124,567 and issued a qualified opinion on compliance with federal laws and regulations for the National Guard Civilian Youth Opportunities Program.

Noncompliance with federal program requirements could result in sanctions, disallowances, and/or future reductions in National Guard Civilian Youth Opportunities Program awards.

The National Guard Civilian Youth Opportunities Program in Michigan comprises two separate subprograms: ChalleNGe and Starbase. Federal expenditures for the National Guard Civilian Youth Opportunities Program totaled \$6.3 million for the two-year period ended September 30, 2007. The Department distributed \$1,101,600 and \$1,770,061 in fiscal year 2005-06 and fiscal year 2006-07, respectively, to Starbase as a subrecipient of the Program. The ChalleNGe Program reported a total of \$3,467,625 in federal expenditures during our audit period, of which \$2,326,917 (67%) related to payroll costs.

* See glossary at end of report for definition.

Our exceptions related to the ChalleNGe Program, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

The Department's internal control did not ensure that it properly documented time reporting in compliance with the allowable costs/cost principles requirements of the ChalleNGe Program.

Appendix B, section 8(h)(3) of Title 2, Part 225 of the *Code of Federal Regulations* (OMB Circular A-87*) states that where employees are expected to work solely on a single federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semiannually and will be signed by the employee or the supervisory official having firsthand knowledge of the work performed by the employee.

Cadre staff* members of the ChalleNGe Program charge 100% of their time on the federal program and certify their time worked through their signature each pay period using manual time sheets. The members' supervisor also certifies the cadre staff members' time worked on the federal program through signature approval of the manual time sheets. The Department uses the biweekly manual time sheet certification process instead of a semiannual certification process. We reviewed 22 manual time sheets for 22 cadre staff members and noted that 17 (77%) cadre staff members signed and submitted their time sheets prior to the last day they worked during the pay period. For example, we noted that cadre staff members signed 14 (82%) of their 17 time sheets 3 or more days prior to the last day worked.

In addition, the supervisory approval signature was also dated prior to the last day the cadre staff member worked during the pay period for the same 17 time sheets with 12 (71%) of the 17 time sheets signed by the cadre staff supervisor 3 or more days prior to the last day worked. In one case, the time sheet was signed and dated by the employee and the supervisor on the Tuesday of the week prior to the beginning of the pay period we reviewed. We

* See glossary at end of report for definition.

also noted that the supervisor's signature for 5 of the 19 time sheets was a photocopy rather than an original signature from the supervisor.

We determined that the Department had no policies or procedures for the ChalleNGe Program regarding time frames for when time sheets were to be signed by cadre staff members or their supervisor as part of the certification process. Due to the internal control deficiency noted regarding the signing and approval of time sheets prior to the last day worked, we were unable to rely on the signed time sheets to meet the periodic certification requirement for all cadre staff members.

b. Reporting

The Department's internal control did not ensure compliance with the reporting requirements of the ChalleNGe Program.

The Master Youth Programs Cooperative Agreement (MYPCA) requires the Department to request periodic reimbursement by submitting a certified statement, no less than once a month, itemizing the amount of funds expended during the preceding month. The MYPCA also requires a final accounting of all funding and disbursements within 90 days after the end of the grant award period or upon termination of the MYPCA. Our review disclosed:

- (1) The Department submitted reimbursement requests late for 26 (84%) of the 31 requests it submitted during our audit period. The Department submitted the reimbursement requests between 1 and 77 days late, averaging 46 days late. Nineteen (61%) of the requests were submitted 10 or more days late.
- (2) The Department submitted 1 of the 2 required final accounting memorandums 73 days after the 90-day due date.

We determined that the Department had no policies or procedures regarding time frames for the preparation and submission of ChalleNGe Program monthly reimbursement requests and annual closeout memorandums.

RECOMMENDATION

We recommend that the Department implement effective internal control to ensure that the National Guard Civilian Youth Opportunities Program complies with federal laws and regulations regarding allowable costs/cost principles and reporting.

OTHER SCHEDULES

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS
Summary Schedule of Prior Audit Findings
As of June 27, 2008

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Audit Findings That Are No Longer Applicable:

Audit Period: October 1, 2003 through September 30, 2005
Finding Number: 510601
Finding Title: Expenditures and Federal Revenue Reporting

Finding: The Department of Military and Veterans Affairs did not comply with State accounting policies regarding the recording of expenditures and federal revenue for funds passed through from other State departments.

Comments: The Department has chosen to follow the Office of Financial Management's (OFM's) position paper and process expenditure credits to the Michigan Department of State Police (MSP) for amounts expended by the Department for the U.S. Department of Homeland Security grants. It is OFM's position that the agency responsible for determining compliance with federal regulations is MSP and that MSP should continue to record the expenditure and related revenue and an expenditure credit should be given to the subgrantee (the Department). As a result, the Department did not report expenditures on its schedule of expenditures of federal awards.

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

Corrective Action Plan

As of June 26, 2008

FINDINGS RELATED TO THE FINANCIAL SCHEDULES

Finding Number: 5110801

Finding Title: Federal Reimbursements

Management Views: The Department of Military and Veterans Affairs agrees with the recommendation to improve its process for requesting federal reimbursement to help ensure timely collection of federal funds.

The Department agrees that it should request all federal funds available to pay for program operations eligible for federal reimbursement.

The Department disagrees that the State lost an opportunity to earn interest of \$864,000.

The Department also questions the average quarterly negative cash position of \$8,325,000.

Corrective Action: As a result of Executive Directive No. 2007-15, the Department requested and received advance payments for Army National Guard program appendices. The advances were for salary and wage only. The Department will continue to use the reimbursement process and will seek monthly advances for all appendices of the Master Cooperative Agreement beginning October 1, 2008. The Department believes that receiving advances along with the monthly reimbursements will help to ensure timely collection of federal funds.

The Department will work within the established ChalleNGe budget reporting system and the Data Management and Reporting System and will work to ensure that as much federal allotment as possible granted to the State of Michigan is captured and spent.

Anticipated Completion Date: October 2008

Responsible Individual: Joel A. Wortley, Chief Financial Officer

Finding Number: 5110802

Finding Title: Schedule of Expenditures of Federal Awards (SEFA)

Management Views: The Department agrees with the recommendation and will strengthen procedures to ensure that future SEFAs are accurate. The Department has been consistent in its methodology in reporting for capital outlay expenditures and revenue. The Department was following what it thought was the acceptable practice for reporting capital outlay projects based on a communication received from an Office of the Auditor General auditor.

Corrective Action: The Department has taken steps to ensure that all federal awards are properly identified and accounted for on the SEFA and drafted procedures to ensure that the Department prepares its SEFA in accordance with U.S. Office of Management and Budget Circular A-133 and State financial management policies. The Department prepared the final fiscal year 2005-06 and 2006-07 SEFAs on the modified accrual basis of accounting.

Anticipated Completion Date: June 1, 2008

Responsible Individual: Joel A. Wortley, Chief Financial Officer

Finding Number: 5110803

Finding Title: Internal Control Over Accounting Transaction Processing

Management Views: The Department recognizes the potential problem resulting from a person who acts by initiating and releasing the same payment document. The Department has reaffirmed with staff the importance of separation of duties and how segregation of these two functions help guard against unintentional errors.

The Department is in agreement with the audit recommendation and will work within the Department to strengthen internal control over the entering and releasing of payment documents.

Corrective Action: The involvement of additional staff in the entering and releasing process will eliminate instances of a single employee both entering and releasing vouchers for payment. If an emergency situation should arise where an individual employee must enter and release a payment document, a subsequent separate review and verification process will take place.

Anticipated Completion Date: July 31, 2008

Responsible Individual: Joel A. Wortley, Chief Financial Officer

Finding Number: 5110804
Finding Title: Internal Control Over Food Purchases and Receipt

Management Views: The Department agrees with the audit recommendation.

Corrective Action: The Department is strengthening its internal control process to ensure that all necessary documentation relative to the purchase, receipt, and authorization of food items is in place.

Anticipated Completion Date: June 30, 2008

Responsible Individual: Frank Snarski, Grand Rapids Home for Veterans (GRHV) Administrator

Finding Number: 5110805
Finding Title: Internal Control Over Records Retention

Management Views: The Department is in agreement with the audit recommendation to review the existing internal control for compliance to ensure that it maintains and safeguards its hard copy accounting records.

Corrective Action: The Department has developed and implemented an internal control policy and procedure to ensure that the hard copy accounting records are stored and destroyed in compliance with its State of Michigan Retention and Disposal of Records Retention Schedule.

Anticipated Completion Date: April 30, 2008

Responsible Individual: Frank Snarski, GRHV Administrator

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 5110806
Finding Title: National Guard Civilian Youth Opportunities,
CFDA 12.404

Management Views: The Department recognizes and agrees with the recommendation that there needs to be effective internal control to ensure that the ChalleNGe Program complies with federal laws and regulations regarding allowable costs/cost principles and reporting. However, the Department disagrees with some of the methodology and conclusions arrived at by the audit staff. The Department does not believe that there is material weakness in these issues nor does it believe that these issues rise to the level of a qualified opinion.

The Department's response to the finding exceptions, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

The Department agrees that, for several of the time sheets, the cadre supervisor's signature on the time sheet was a photocopy rather than an original signature. The ChalleNGe Program has taken appropriate steps to ensure that this never occurs again. The cadre supervisor did review all time sheets prior to submission to the timekeeper regardless of whether or not his signature was a photocopy.

b. Reporting

The Department agrees that the requests for reimbursement for the ChalleNGe Program need to be submitted in a more timely fashion in accordance with the Master Youth Programs Cooperative Agreement. The Department also

agrees that final accounting memorandums closing out the grant award year need to be submitted within established due dates.

The Department is in the process of updating its administrative manual to formalize the desk operating procedures currently followed. This will allow for more timely submission of requests for reimbursement and closeout letters.

Corrective Action:

The Department has obtained the semiannual certifications for the audit period. The certifications have been signed by the supervisory official having firsthand knowledge of the work performed by the cadre staff.

The Department has drafted procedures to ensure compliance with the reporting requirements of the ChalleNGe Program.

Anticipated Completion Date: October 2008

Responsible Individual: Joel A. Wortley, Chief Financial Officer

GLOSSARY

Glossary of Acronyms and Terms

cadre staff	ChalleNGe Program staff who carry out a variety of tasks providing direction to at-risk youth. Duties include providing direction to cadets in the areas of personal hygiene; uniform care and maintenance; and compliance with program policies, rules, and regulations.
<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
control deficiency in internal control over federal program compliance	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance requirement of a federal program.
control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
DMB	Department of Management and Budget.
GRHV	Grand Rapids Home for Veterans.
in-kind assistance	The value of a noncash contribution by a nonfederal third party without charge to the grantee or a cost-type contractor of supplies, equipment, goods, property, and services, directly benefiting and specifically identifiable to a federal program.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting,

effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

low-risk auditee

As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.

material misstatement

A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.

material
noncompliance

Violations of laws, regulations, contracts, and grants that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.

material weakness in
internal control over
federal program
compliance

A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected.

material weakness in
internal control over
financial reporting

A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected.

MSP

Michigan Department of State Police.

MYPCA

Master Youth Programs Cooperative Agreement.

OFM

Office of Financial Management.

OMB	U.S. Office of Management and Budget.
OMB Circular A-87	Guidance regarding "Cost Principles for State, Local, and Indian Tribal Governments," which has been incorporated into the <i>Code of Federal Regulations</i> as Title 2, Part 225 (i.e., federal regulation 2 <i>CFR</i> 225).
pass-through entity	A nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.
qualified opinion	<p>An auditor's opinion in which the auditor:</p> <ul style="list-style-type: none"> a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the financial schedules and/or financial statements presenting the basic financial information of the audited agency in conformity with the disclosed basis of accounting or the financial schedules and/or financial statements presenting supplemental financial information in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or b. Expresses reservations about the audited agency's compliance, in all material respects, with the cited requirements that are applicable to each major federal program.
questioned cost	A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible

violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

SEFA

schedule of expenditures of federal awards.

significant deficiency
in internal control over
federal program
compliance

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected.

significant deficiency
in internal control over
financial reporting

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have

a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

subrecipient

A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion

An auditor's opinion in which the auditor states that:

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or
- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or
- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

USPFO

United States Property and Fiscal Office.

